SUPREME COURT, U. S.
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No. 120

In the Supreme Court of the United States

OCTOBER TERM, 1961

JOHN W. CHAMBERLIN and MARIAN McMICHAEL CHAMBERLIN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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JOHN W. CHAMBERLIN and MARIAN MCMICHAEL CHAMBERLIN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE [1]

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 6a-36a) are reported at 32 T. C. 1098. The opinion of the Court of Appeals (Pet. 27-36) is reported at 286 F. 2d 850.

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[1] The cover and caption of the petition for certiorari erroneously refer to the United States of America as the respondent.

JURISDICTION

The judgment of the Court of Appeals was entered on November 30, 1960. (Pet. 37.) A petition for rehearing was denied on March 20, 1961. (Pet. 38.) The petition for certiorari was filed on May 29, 1961. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether a patent royalty contract is by its nature so speculative and uncertain that, as a matter of law, it can have no fair market value, or whether, as the court below held, the question of fair market value is one of fact, to be determined under the circumstances of the particular contract.

2. Whether both courts below erred in finding as facts that Mrs. Chamberlin was not the owner of certain patents in 1943 and did not at that time grant a new license to Borg-Warner Corporation.

STATUTES INVOLVED

Relevant portions of Sections 22(a), and 117(a) and (b) of the Internal Revenue Code of 1939, and of Sections 111(b) and 112(a) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, are printed in the Appendix, *infra*, pp. 16-17.

STATEMENT

The facts as found by the Tax Court (R. 8a-17a), and accepted by the Court of Appeals (Pet. 28-31), may be summarized as follows:

I

In 1933, the taxpayer, John W. Chamberlin, was issued a patent covering a cleansing machine. Rex Earl Bassett, Jr., was issued a patent on certain improvements in washing machines. In 1935 an exclusive license under the Chamberlin and Bassett patents in the field of domestic laundry machines was acquired by Laundri-Matic Corporation, in which Chamberlin and Bassett each owned 26 of its 100 shares of authorized stock. (R. 8a; Pet. 28.)

On April 23, 1935, Laundri-Matic granted to Hydraulic Brake Company an exclusive transferable license, in the domestic laundry field only, to manufacture, use and sell laundry machines covered by the Chamberlin and Bassett patents throughout the lives of the patents. The agreement could be canceled by the licensee on 60 days' notice, and by the licensor on 60 days' notice if the licensee defaulted in royalty payments. (R. 8a-9a; Pet. 28.)

As of July 17, 1936, the stockholders of Laundri-Matic were as follows (R. 9a; Pet. 28):

John W. Chamberlin	26 shares
Rex Earl Bassett, Jr.	26 shares
Arthur A. Berard	24 shares
J. C. Rowland	12 shares
Don O. Scott	12 shares
Total	100 shares

The 12 shares held by Scott had been purchased by Bassett's wife from Rowland and then sold by her to Scott at some time after February, 1935, but prior to July 17, 1936. (R. 9a; Pet. 28.)

By an agreement dated July 17, 1936, Laundri-

Matic assigned to Chamberlin the right to receive 20 per cent of all royalties accruing or thereafter paid to Laundri-Matic under the Hydraulic license, the payments to be made directly to Chamberlin by Hydraulic. In exchange, Chamberlin agreed to transfer to Laundri-Matic 20 of his 26 shares of stock. (R. 9a-11a; Pet. 28-29.)

By an agreement dated December 4, 1937, Laundri-Matic assigned to Chamberlin the right to receive an additional six per cent of the royalties payable under the Hydraulic license in exchange for which Chamberlin agreed to transfer his remaining six shares of stock to Laundri-Matic. (R. 11a; Pet. 29.)

On December 7, 1937, Chamberlin completed the transfer of his 26 shares of stock to Laundri-Matic pursuant to the agreements. On the same day he assigned to his wife, Marian, his six per cent interest in the royalties. No consideration was paid and this transfer to Marian was a gift. (R. 11a-12a; Pet. 29.)

Laundri-Matic had few assets other than the right to receive royalty payments under the Hydraulic license. (R. 12a; Pet. 29.)

On August 10, 1936, Hydraulic had assigned its rights under the license to Bendix Home Appliances, Inc., which assumed its obligations under the license. (R. 12a; Pet. 29.)

In their income tax returns for 1947 to 1949, the taxpayers treated the royalties received by them from Bendix as proceeds from the sale or exchange of the Laundri-Matic stock and hence taxable as capital

gain.[2] The Tax Court, in an opinion reviewed by the entire court, sustained the Commissioner's determination that they were taxable as ordinary income. (R. 21a-27a.) The Court of Appeals affirmed. (Pet. 31-34.) In an opinion in a closely similar case, *Marsack's Estate* v. *Commissioner*, argued and decided after the filing of the petition for rehearing in the present case, 288 F. 2d 533, 536, the court further explained its decision in the present case:

> In spite of the emphatic statement of counsel for taxpayers, our decision herein, as well as our decision in *Chamberlin*, does not mean that speculative contracts which contain highly contingent possibilities of future realization of income, can and must be valued for income tax purposes as a matter of law. The question is one of fact and not of law. We recognize there have been cases where courts have properly considered a contract so speculative and contingent as to make impossible the ascertainment of market value. But that is not the case here.

II

Chamberlin and Bassett, on December 24, 1937, formed the Chamberlin Bassett Research Corporation, hereinafter called Research, to which, in November, 1938, they assigned all their right, title and interest to inventions and patents in the field of commercial laundry machines. Research also acquired title to additional patent rights from various em-

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[2] The parties are in agreement that the royalties paid to Marian Chamberlin are taxable on the same basis as the amounts received by her husband.

ployees. Chamberlin and Bassett each owned 400 shares of stock in Research, and their wives 100 shares each, for a total of 1,000 shares. (R. 12a; Pet. 29.)

In February, 1939, Research granted an exclusive license to Borg-Warner Corporation to manufacture, use and sell for domestic use laundry machines and devices designed to handle more than 18 pounds of dry material in one load. Borg-Warner agreed to pay Research a royalty for each machine sold during each year the license was in effect, with a minimum monthly royalty, and also agreed to furnish Research with written statements specifying the number of machines sold during each month. The agreement provided that it should remain in force until the last patent covered by it should expire, unless previously terminated as provided in the agreement. Borg-Warner could cancel 90 days after giving written notice thereof, and Research could terminate the license upon 30 days' notice in the event of Borg-Warner's failure to pay royalties, render statements required by the agreement, or comply with other obligations in the agreement, or in the event of bankruptcy, insolvency or liquidation of Borg-Warner. (R. 12a-13a; Pet. 29-30.)

By agreement dated March 13, 1939, Research sold and assigned to Chamberlin and Bassett each a 50 per cent interest in and to all royalties thereafter accruing or paid by Borg-Warner under the Borg-Warner license. (R. 13a; Pet. 30.)

On December 5, 1939, Marian Chamberlin purchased her husband's 400 shares of Research stock,

and in June 1940 she purchased the 500 shares owned by Bassett and his wife, leaving her the sole stockholder. (R. 13a; Pet. 30.)

By corporate resolution adopted June 17, 1940, Chamberlin and Marian were authorized and empowered to sell any assets of Research. Pursuant to this resolution, rights which Research had acquired were sold. It is not clear from the evidence whether any rights that were retained by Research under the Borg-Warner license were distributed in liquidation or retained by the corporation, but on the advice of its attorneys, Research was not formally dissolved. However, essentially all of the assets of Research were thus disposed of during the year 1941. (R. 13a-14a; Pet. 30.)

By assignment dated August 25, 1940, Chamberlin sold to Marian all rights to receive royalties which had or might thereafter accrue to him under the license agreement between Research and Borg-Warner by reason of the assignment to him by Research of the right to receive such payments, and whatever rights might revert to him or Research in the event the Borg-Warner license should terminate. (R. 14a; Pet. 30.)

By letter dated February 28, 1942, Research and Marian notified Borg-Warner of an intention to cancel the Borg-Warner license for default in payment of royalties and failure to render certain statements required by the license agreement. The notification was signed for Research by Chamberlin as president, and was also signed by Marian. (R. 14a; Pet. 30.)

In a letter dated March 24, 1942, Borg-Warner

denied that it was in default under the license agreement. The letter stated that it was not in default regarding the payment of royalties but had in fact advanced on behalf of Research a greater amount than was due as royalties under the license. (R. 14a; Pet. 30.) Concerning the allegation of default for failure to render statements of machines manufactured and sold by Borg-Warner, the letter stated (R. 14a):

> Technically, we may be in default under Section 1, Article IV, for not having reported each month the number of "Licensed Apparatus" manufactured and sold by us. However, we are reporting to you now that we have sold no "Licensed Apparatus" since the License Agreement was entered into, as you are fully aware.

Negotiations were conducted from April 1942 until April 1943 between Borg-Warner and Louis C. Chapleau, attorney for Marian, regarding the question of default. (R. 15a; Pet. 30-31.)

On April 15, 1943, Chapleau, as trustee for Marian, purchased from Bassett his right to receive 50 per cent of the royalties payable under the Borg-Warner license, which he later transferred to Marian. (R. 15a; Pet. 31.)

On April 17, 1943, the dispute with Borg-Warner was settled and the following letter of agreement addressed to Norge Division, Borg-Warner Corporation, was signed by Marian Chamberlin, Louis C. Chapleau, trustee, and Chamberlin Bassett Research Corporation, by Chamberlin as president (R. 15a; Pet. 31):

Gentlemen:

The undersigned, being the owners of the entire interest arising out of and by reason of a certain option agreement dated December 1st, 1938 and a patent license agreement which became effective by a letter of acceptance dated February 23rd, 1939 between Chamberlin Bassett Research Corporation and Borg-Warner Corporation, hereby acknowledge that all royalty payments due under and by virtue of the provisions of said license agreement have been fully paid up to April 1st, 1943.

We further agree that said license agreement is in full force and effect and that any notices of cancellation heretofore given for alleged breach of contract were premature and ineffective.

The undersigned further acknowledge receipt of the sum of $12,000 in payment of minimum royalties at the rate of $1,000 a month from April 1, 1943 to April 1, 1944. Earned royalties in excess of the minimum, if any, will be accounted for on April 1, 1944.

Thereafter all payments under the license agreement were made to Marian. (R. 16a; Pet. 31.)

The taxpayer, Marian Chamberlin, contended that the payments to her from Borg-Warner were taxable as capital gain, as the proceeds of the sale or assignment of a patent by her. The Tax Court held that Marian had not established either that she owned of the patent (R. 25a), or that the reinstatement of the exclusive license agreement was a sale or exchange of a capital asset (R. 25a-27a). The Court of Appeals agreed. (Pet. 34-36.)

ARGUMENT

I

The sole basis of the claim that the Bendix royalties were capital gain is that they constituted the proceeds of the 1936 sale or exchange by Chamberlin of his stock in Laundri-Matic. Both courts below held that the sale or exchange of the stock was completed in 1936; that the amount realized on the sale was the then value of the property received in exchange—namely, the contract right to the future royalties under the Bendix license—the excess of which over the taxpayers' basis in the stock was taxable in that year as capital gain;[3] and that the royalties thereafter received constituted simply the return on an income-producing asset taxable as ordinary income.[4] Taxpayers contend that the value of the contract right received in exchange for the stock in 1936 was unascertainable and that, therefore, the

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[3] Section 111(b) of the Revenue Act of 1936, Appendix, *infra*, p. 17, provided, in the same terms as Section 111 of the Internal Revenue Code of 1939, that the amount realized from the sale or other disposition of property shall be the sum of any money received, plus the fair market value of property (other than money) received. Section 112(a), Appendix, *infra*, p. 17, sets out the general rule that upon the sale or exchange of property the entire amount of the gain or loss, determined under Section 111, should be recognized.

[4] The taxpayers' basis in their contract rights could of course be recovered by depreciation deductions over the life of the contract, but the taxpayers here made no attempt to establish a basis (Pet. 31).

transaction must be kept open and the royalty payments themselves be treated as deferred payments received in exchange for the stock.

Despite the repeated references in the petition to "speculative" contract rights, there was no evidence introduced in the trial to show that the rights here were in fact so speculative and the future payments so uncertain that the contract could not be valued, and, as the courts below pointed out (R. 20a-21a, Pet. 33-34), there was evidence to the contrary. The taxpayers' contention is basically that, *as a matter of law*, a simple contract providing for future payments cannot be valued and can never be considered the equivalent of cash.

In its rejection of this contention, the decision of the court below is in accord with the decisions of other Courts of Appeals. The conflict alleged in the petition (pp. 11-12) does not exist.

The Ninth Circuit, in *Gersten* v. *Commissioner*, 267 F. 2d 195, 197, specifically rejected the contention there that it is "a rule of law that a fair market value for such a contract can never be established at the date of liquidation," and distinguished its own case of *Westover* v. *Smith*, 173 F. 2d 90, cited in the petition (p. 12), where there were additional factors rendering the contract's value unascertainable.

In *Commissioner* v. *Carter*, 170 F. 2d 911 (C. A. 2d), the parties had stipulated that the contracts had no ascertainable market value. Furthermore, in *Campagna* v. *United States*, decided May 10, 1961 (7 A.F.T.R. 2d 1358), the Second Circuit held that the question as to whether the transaction was closed

is one of fact, citing with approval *Gersten* v. *Commissioner*, *supra*, and the Tax Court decision in the present case.

Commissioner v. *R. J. Darnell, Inc.*, 60 F. 2d 82 (C. A. 6th), cited in the petition (p. 12), does not purport to set out any such general rule as the taxpayers urge here. Instead, as its subsequent decisions show, the Sixth Circuit also regards the question of ascertainability of fair market value as one of fact. See *Doric Apartment Co.* v. *Commissioner*, 94 F. 2d 895 (C. A. 6th); *Miller* v. *United States*, 235 F. 2d 553 (C. A. 6th). Also in accord with the opinion below in the present case are *Osenbach* v. *Commissioner*, 198 F. 2d 235 (C. A. 4th), and *Warren* v. *United States*, 171 F. Supp. 846 (C. Cls.), certiorari denied, 361 U. S. 916.

In *Burnet* v. *Logan*, 283 U. S. 404, the taxpayer sold stock in a corporation for a sum of cash plus a contract right to receive future payments based upon iron ore produced under a mining lease. The sum of the cash payment and the contract payments received did not, in the taxable year in issue, exceed the taxpayer's basis for the stock. Thus the question presented was whether the tax asserted was imposed upon capital rather than income or profits. In that case there were many uncertainties which might prevent the return of capital, and it was held that the taxpayer was entitled to recover her capital investment before any of the payments would be regarded as taxable income. There was no provision for capital gains in the applicable Revenue Acts, and this Court had no occasion to consider that issue.

Its decision did not purport to lay down a universal rule that contracts for indefinite payments have no ascertainable value.

In support of their proposition that receipt of rights in an ordinary contract calling for future payments cannot be a closed transaction as a matter of law, the taxpayers cite a number of Tax Court decisions holding that on the facts there involved the transaction under review was not closed. Despite some broad language in some of the opinions, it is evident that the court did not itself think it was laying down a rule of the scope for which taxpayers contend. The opinion in the instant case, reviewed by the entire court, states specifically (R. 20a) that—

> There is nothing inherent in a contract or claim for the future payment of indefinite amounts that causes it to be insusceptible of valuation.

The Court of Appeals agreed. (Pet. 33.)

The decisions are in accord with and apply the long established rule that—

> The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value.

Treasury Regulations 118, Section 39.111-1; Treasury Regulations 111, Section 29.111-1; Treasury Regulations 103, Section 19.111-1; Treasury Regulations 101, Article 111-1; Treasury Regulations 94, Article 111-1; Treasury Regulations 86, Article 111-1; Treasury Regulations 77, Article 561; Treasury Regulations 74, Article 561. In Rev. Rul. 58-402, 1958-2

Cum. Bull. 15, dealing specifically with patent contracts, the Commissioner was merely invoking and applying a principle set out in the Regulations without even verbal change for more than 30 years.

To summarize, the decision below applies to the facts of this case a well established principle, as to which there is no conflict with other Courts of Appeals or with the decisions of this Court.

II

As to the Borg-Warner royalties, the taxpayers (Pet. 23-25) are requesting this Court to review the factual determination of both courts below that it had not been shown that Mrs. Chamberlin was the owner of the patent at the time the license was entered into or at the time of the settlement with Borg-Warner, and that it had not been shown that the original license was ever cancelled. Unless these factual determinations, fully supported by the evidence, were reversed, the alleged conflict (Pet. 24) would not arise.

CONCLUSION

The decision of the court below, as to both issues, turns upon factual determinations. There is no conflict of principle with the decisions of other Courts of Appeals or of this Court. The petition for certiorari should be denied.

Respectfully submitted,

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JUNE, 1961.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business) * * *

* * * *

(b) [As amended by Sec. 150(c), Revenue Act of 1942, c. 619, 56 Stat. 798] *Percentage Taken into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * *

(26 U.S.C. 1952 ed., Sec. 117.)

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 111. *Determination of Amount of, and Recognition of, Gain or Loss.*

* * * *

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of the money received plus the fair market value of the property (other than money) received.

* * * *

SEC. 112. *Recognition of Gain or Loss.*

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * *

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